

PERFORMANCE AUDIT
OF
MULTIFAMILY PROGRAMS
OF THE
MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY
DEPARTMENT OF CONSUMER AND INDUSTRY SERVICES

July 2001

EXECUTIVE DIGEST

MULTIFAMILY PROGRAMS

INTRODUCTION	This report contains the results of our performance audit* of Multifamily Programs of the Michigan State Housing Development Authority (MSHDA), Department of Consumer and Industry Services.
AUDIT PURPOSE	This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.
BACKGROUND	<p>MSHDA's mission* is to expand the availability and supply of decent, affordable, and accessible rental housing for people with low and extremely low incomes.</p> <p>MSHDA administers the federal Low Income Housing Tax Credit (LIHTC) Program in Michigan, which is the primary program for funding multifamily developments. The federal Tax Reform Act of 1986 created the LIHTC Program. MSHDA also administers the federal HOME Program*, which provides nonprofit and for-profit agencies with funding to assist in the development of rental units for low-income households and special needs populations. Using tax-exempt bond proceeds, MSHDA established the Tax-Exempt Apartments for Michigan (TEAM) Program to</p>

* See glossary at end of report for definition.

finance multifamily developments, primarily for low-income households. MSHDA also developed the Taxable Bond Program. Both the TEAM Program and the Taxable Bond Program are designed to be used in conjunction with the LIHTC Program. In addition, MSHDA performs tenant eligibility audits at the various multifamily developments to ensure compliance with program requirements.

**AUDIT OBJECTIVES
AND CONCLUSIONS**

Audit Objective: To determine whether MSHDA effectively assisted in the planning, construction, and financing of needed rental housing for low- and moderate-income individuals and individuals with special needs.

Conclusion: We concluded that MSHDA was generally effective in the planning, construction, and financing of rental housing. However, we noted reportable conditions* relating to allocation of tax credits, internal control over allocating tax credits, construction monitoring - architects, construction monitoring - MSHDA staff, compliance with specifications, insurance coverage and licensing, and records of proposed developments (Findings 1 through 7).

Audit Objective: To determine whether MSHDA safeguarded its financial interest in housing developments by monitoring the finances and physical maintenance of the developments.

Conclusion: We concluded that MSHDA effectively monitored the finances and physical maintenance of the developments.

* See glossary at end of report for definition.

Audit Objective: To assess the effectiveness of MSHDA's monitoring of tenant eligibility for rent subsidies at multifamily developments.

Conclusion: We concluded that MSHDA's monitoring of tenant eligibility for rent subsidies was effective.

Audit Objective: To assess the effectiveness of MSHDA's monitoring of tenant income, age, and other requirements for the type of financing received to construct the multifamily developments.

Conclusion: We concluded that MSHDA's monitoring of tenant requirements for financing was generally effective. However, we noted reportable conditions related to comprehensive policies and procedures for tenant eligibility audits and selection of developments for tenant eligibility audits (Findings 8 and 9).

AUDIT SCOPE AND
METHODOLOGY

Our audit scope was to examine the program and other records of the multifamily programs of the Michigan State Housing Development Authority. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit methodology included examination of MSHDA's process for reviewing and approving proposals from developers, its monitoring of construction for financed developments, its monitoring of development finances and physical maintenance, its monitoring of tenant eligibility, and its monitoring of compliance with tenant requirements for the period October 1996 through October 1999.

AGENCY RESPONSES

Our audit report includes 9 findings and 9 corresponding recommendations. MSHDA's preliminary response indicated that it generally agreed with our recommendations and has taken steps to implement most of them.

July 10, 2001

Mr. James L. Logue III, Executive Director
Michigan State Housing Development Authority
Plaza One Building
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Mr. Logue and Ms. Wilbur:

This is our report on the performance audit of Multifamily Programs of the Michigan State Housing Development Authority, Department of Consumer and Industry Services.

This report contains our executive digest; description of programs; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

This page left intentionally blank.

TABLE OF CONTENTS

MULTIFAMILY PROGRAMS MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY DEPARTMENT OF CONSUMER AND INDUSTRY SERVICES

INTRODUCTION

	<u>Page</u>
Executive Digest	1
Report Letter	5
Description of Programs	8
Audit Objectives, Scope, and Methodology and Agency Responses	9

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

Planning, Construction, and Financing of Rental Housing	11
1. Allocation of Tax Credits	12
2. Internal Control Over Allocating Tax Credits	14
3. Construction Monitoring - Architects	15
4. Construction Monitoring - MSHDA Staff	16
5. Compliance With Specifications	17
6. Insurance Coverage and Licensing	18
7. Records of Proposed Developments	19
Safeguarding Financial Interest	21
Tenant Eligibility for Rent Subsidies	22
Tenant Requirements for Financing	22
8. Comprehensive Policies and Procedures for Tenant Eligibility Audits	22
9. Selection of Developments for Tenant Eligibility Audits	25

GLOSSARY

Glossary of Acronyms and Terms	27
--------------------------------	----

Description of Programs

The Michigan State Housing Development Authority (MSHDA) was established by Act 346, P.A. 1966, under the former Department of Social Services and is now part of the Department of Consumer and Industry Services. MSHDA operates a variety of programs to provide financial and technical assistance through public and private partnerships to create and preserve decent, affordable housing for low- and very low-income Michigan residents. These programs include financing and other forms of assistance for single-family and multifamily housing.

MSHDA administers the federal Low Income Housing Tax Credit (LIHTC) Program in Michigan, which is the primary program for funding multifamily developments. The federal Tax Reform Act of 1986 created the LIHTC Program. MSHDA also administers the federal HOME Program, which provides nonprofit and for-profit agencies with funding to assist in the development of rental units for low-income households and special needs populations. Using tax-exempt bond proceeds, MSHDA established the Tax-Exempt Apartments for Michigan (TEAM) Program to finance multifamily developments, primarily for low-income households. MSHDA also developed the Taxable Bond Program. Both the TEAM Program and the Taxable Bond Program are designed to be used in conjunction with the LIHTC Program. In addition, MSHDA performs tenant eligibility audits at the various multifamily developments to ensure compliance with program requirements.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit of Multifamily Programs of the Michigan State Housing Development Authority (MSHDA), Department of Consumer and Industry Services, had the following objectives:

1. To determine whether MSHDA effectively assisted in the planning, construction, and financing of needed rental housing for low- and moderate-income individuals and individuals with special needs.
2. To determine whether MSHDA safeguarded its financial interest in housing developments by monitoring the finances and physical maintenance of the developments.
3. To assess the effectiveness of MSHDA's monitoring of tenant eligibility for rent subsidies at multifamily developments.
4. To assess the effectiveness of MSHDA's monitoring of tenant income, age, and other requirements for the type of financing received to construct the multifamily developments.

Audit Scope

Our audit scope was to examine the program and other records of the multifamily programs of the Michigan State Housing Development Authority. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit fieldwork was completed between March and October 1999. Our audit methodology included examination of MSHDA's records and activities covering the period October 1996 through October 1999.

To accomplish our first objective, we examined MSHDA's process for reviewing and approving proposals from developers, including determining whether there was substantial need for the type of housing being proposed. We also examined MSHDA's monitoring of construction for financed developments for compliance with U.S. Department of Housing and Urban Development and MSHDA standards.

To accomplish our second objective, we examined MSHDA's monitoring of development finances and physical maintenance and its review of development files to determine whether this monitoring is being conducted in accordance with established procedures.

To accomplish our third objective, we examined MSHDA's monitoring of tenant eligibility and its review of development files to determine whether this monitoring is being conducted in accordance with established procedures.

To accomplish our fourth objective, we examined MSHDA's monitoring of compliance with tenant income, age, and other requirements for the type of financing received to construct developments.

Agency Responses

Our audit report includes 9 findings and 9 corresponding recommendations. MSHDA's preliminary response indicated that it generally agreed with our recommendations and has taken steps to implement most of them.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Consumer and Industry Services to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

PLANNING, CONSTRUCTION, AND FINANCING OF RENTAL HOUSING

COMMENT

Background: The Michigan State Housing Development Authority's (MSHDA's) mission is to expand the availability and supply of decent, affordable, and accessible rental housing for people with low and extremely low incomes. MSHDA has developed or participated in a variety of programs related to rental housing.

Section 125.1422(b) of the *Michigan Compiled Laws* authorizes MSHDA to undertake and carry out studies and analyses of housing needs within the State and ways of meeting those needs, to make the results of those studies and analyses available to the public and the housing industry, and to engage in research and disseminate information on housing.

MSHDA did not identify specific areas with unmet low-income housing needs so that it could notify communities of the needs and enable developers to use the information when deciding on a development location. Instead, MSHDA procedures called for developers to submit marketing studies identifying unmet low-income housing needs for the locations they selected. As a result, MSHDA may not have identified locations that required incentives for developers to submit proposals in order to serve locations with the greatest need for low-income housing.

Audit Objective: To determine whether MSHDA effectively assisted in the planning, construction, and financing of needed rental housing for low- and moderate-income individuals and individuals with special needs.

Conclusion: We concluded that MSHDA was generally effective in the planning, construction, and financing of rental housing. However, we noted reportable conditions relating to allocation of tax credits, internal control over allocating tax credits, construction monitoring - architects, construction monitoring - MSHDA staff, compliance

with specifications, insurance coverage and licensing, and records of proposed developments.

FINDING

1. Allocation of Tax Credits

MSHDA needs to develop a formal process to document allocations of tax credits that are not specifically provided for in the qualified allocation plan (QAP) and also to establish procedures to correct errors or mistakes made during the allocation process.

MSHDA is responsible for administering the Low Income Housing Tax Credit (LIHTC) Program and for the annual preparation of the QAP. Federal regulations govern the development of the QAP, which provides the criteria by which MSHDA awards tax credits on a competitive basis. These tax credits are awarded during two funding rounds held each calendar year. State and federal law, along with MSHDA priorities, also establish minimum amounts (set-aside percentages) that are required to be allocated to projects sponsored by nonprofit agencies, rural projects, projects in distressed areas, and projects for the elderly.

Our review of LIHTC allocations disclosed the following practices:

- a. Minimum set-aside percentages were allocated by funding round instead of by every calendar year, as provided in the QAP.
- b. Projects that qualified for set-aside categories that scored high enough on a competitive basis to receive funding were sometimes not included in those set-aside categories for determining whether minimum percentages had been met.
- c. Projects that received more than 50% but less than 100% of total eligible tax credit allocations in one funding round were granted the remainder of the total eligible tax credit allocation in the subsequent funding round without being required to go through the competitive process again.

This included one large project that received 50% of the total tax credit that it was eligible for in one round and received the remaining 50% in the subsequent funding round, even though it scored high enough to receive the

entire amount of the tax credit in the initial funding round. MSHDA staff indicated that this was done so that the project would not take up an excessively large portion of the total tax credits available in any one funding round.

- d. Applicants for tax credit allocations frequently had questions about the score received from MSHDA and were allowed to review final scores with MSHDA staff after each allocation round. However, MSHDA had no written procedures to address errors or mistakes made during the allocation process.

Although these practices were not contrary to State and federal law or to the QAP, MSHDA did not formally document the decisions made in the allocation of tax credits. We also noted that the formal approval of policy bulletins, which supplement the provisions and procedures contained in the QAP, was not documented.

The interpretation of the provisions for the set-aside categories could affect which projects receive tax credits.

RECOMMENDATION

We recommend that MSHDA develop a formal process to document allocations of tax credits that are not specifically provided for in the QAP and also establish procedures to correct errors or mistakes made during the allocation process.

AGENCY PRELIMINARY RESPONSE

MSDHA agreed with this recommendation and informed us that, since January 1, 2000, the QAP has stated that the set-asides will be met on a funding round basis.

MSHDA also informed us that only projects that receive at least 50% of their eligible credit in a funding round (in which they met all requirements of the QAP) are awarded credit outside the QAP. A policy was developed in 1998 that established a process to allocate credit to these projects. This policy was being amended at the time of the audit in 1999 and had not been approved.

MSHDA added that it will establish written procedures to correct errors or mistakes made during the funding rounds.

FINDING

2. Internal Control Over Allocating Tax Credits

MSDHA needs to improve its internal control to ensure that the process for allocating tax credits is properly documented.

Our review of the LIHTC Program disclosed:

- a. MSHDA had not sufficiently documented the scoring process for proposals received from LIHTC applicants. Three MSHDA staff members review and score applicants. However, written documentation of this scoring process, including signed individual and composite scoring sheets, was not completed and retained.
- b. MSHDA had not instituted procedures to document that tax credits were awarded in accordance with the QAP and policy bulletins. MSDHA's LIHTC Program director coordinates the receipt and scoring of the applications, reviews the scoring process for errors or omissions during funding rounds, makes preliminary funding recommendations based on application scores and statutory set-asides, and meets with MSHDA's executive director and director of Legal Affairs to finalize tax credit awards and mitigate errors made in the allocation process. However, MSDHA did not formally document the procedures followed by the director of the Tax Credit Program to ensure that credits were allocated according to the QAP. Further, MSDHA did not document the reviews of the allocation process by MSHDA's executive director or director of Legal Affairs.

RECOMMENDATION

We recommend that MSHDA improve its internal control to ensure that the process for allocating tax credits is properly documented.

AGENCY PRELIMINARY RESPONSE

MSHDA agreed with this recommendation. MSHDA informed us that the following procedures were implemented for the March 2000 and subsequent funding rounds:

- (a) The score sheets of all three reviewers will be retained for three years. Each reviewer initials the final score sheet, signifying agreement with the final total score.

- (b) The LIHTC Program director or a member of the LIHTC Program staff develops a minimum of two award lists by set-aside. These are discussed with MSHDA's executive director and the director of Legal Affairs. All three sign the final award list, signifying approval.

FINDING

3. Construction Monitoring - Architects

MSHDA should ensure that the architects responsible for monitoring the construction of MSHDA-funded developments conduct on-site visits during the construction process as required by MSHDA procedures.

MSHDA's Construction Manual for Architect's Supervisory Services specifies that:

Site field visits are normally conducted at least weekly, however, proper review may require that thoroughness and frequency vary with the various phases of the work within the construction process.

We reviewed the project files for 5 developments under construction during our audit and noted that, for 1 development, the architect conducted an average of one on-site visit every four weeks during the 13-month construction period. We also noted one instance for this same project in which more than two months elapsed between the architect's on-site visits.

MSHDA's construction project files did not contain documentation explaining why the required weekly on-site visits were not conducted or why MSHDA did not enforce the on-site visit requirements. As a result, MSHDA reduced its ability to obtain assurance from the project's architect that the quality of construction was acceptable and conformed to plans, specifications, and governing codes throughout the construction process.

RECOMMENDATION

We recommend that MSHDA ensure that the architects responsible for monitoring the construction of MSHDA-funded developments conduct on-site visits during the construction process as required by MSHDA procedures.

AGENCY PRELIMINARY RESPONSE

MSHDA agreed with this finding and informed us that it has taken steps to implement the recommendation.

FINDING

4. Construction Monitoring - MSHDA Staff

MSHDA should ensure that its construction management staff conduct sufficient on-site visits during the construction of MSHDA-funded developments as required by MSHDA procedures or document why these visits are not necessary.

MSHDA's Preconstruction Conference Manual specifies that:

Inspections are normally conducted on a weekly basis, however proper inspections require that the frequency and intensity of inspections vary with the various phases of the work within the construction process.

We reviewed the project files for 5 construction projects in progress during our audit. We noted that, for 2 developments, weekly on-site visits by construction management staff were not conducted. Our review disclosed five instances in which the period between on-site visits exceeded one month, including one instance in which the period between on-site visits exceeded two months. There may be occasions when weekly on-site visits are not necessary; however, the project files for these projects did not contain any documentation to explain why the weekly on-site visits were not conducted.

RECOMMENDATION

We recommend that MSHDA ensure that its construction management staff conduct on-site visits during the construction of MSHDA-funded developments as required by MSHDA procedures or document why these visits are not necessary.

AGENCY PRELIMINARY RESPONSE

MSHDA agreed with this recommendation and informed us that it has taken steps to implement it.

FINDING

5. Compliance With Specifications

MSHDA did not always document in project files that materials used in the MSHDA-funded developments met all specifications.

We reviewed the development files for 5 construction projects in progress during our audit and noted that the results of 19 concrete slump tests and 12 compression strength tests did not meet required specifications for 1 construction project. These tests were conducted by a company that specializes in these types of tests.

Concrete slump tests are performed prior to the concrete being poured and are designed to determine whether the concrete is properly mixed. The specifications that MSHDA approved required these tests. The test results provide a preliminary indication of whether the concrete will eventually meet the minimum required strength desired for the structure. The maximum amount of slump allowable for this project ranged from 4 to 5 inches, depending on the use of the concrete. The actual results from 19 of these tests showed a slump ranging from 1 to 7 $\frac{3}{4}$ inches.

The results for 14 (74%) of these tests exceeded the maximum range allowed by MSHDA specifications, which made it questionable whether the concrete would meet the minimum strength requirements.

MSHDA also requires compression strength tests to be performed on samples obtained while the concrete is being poured. These tests are conducted 28 days after the concrete is poured. These tests are intended to determine whether the compression strength of the concrete met required specifications. Our review disclosed that the results of 12 compression strength tests did not meet the specifications required by MSHDA. Further concrete strength tests were conducted to obtain assurance that the concrete ultimately met the required strength requirements for 3 of the 12 locations that received the concrete that did not meet the initial compression testing requirements. However, there was no documentation that the other 9 locations were tested to determine if they ultimately met the required strength specifications.

MSHDA frequently requires contractors to provide an additional warranty for work that was not performed in accordance with standards and specifications. MSHDA did not obtain any additional warranties from the contractors responsible for this project.

RECOMMENDATION

We recommend that MSHDA document in project files that materials used in the MSHDA-funded developments meet all specifications.

AGENCY PRELIMINARY RESPONSE

MSHDA agreed with this recommendation.

FINDING

6. Insurance Coverage and Licensing

MSHDA did not ensure that architects and general contractors maintained required insurance coverage and licensing until MSHDA-funded developments were completed.

Our review disclosed:

- a. MSHDA did not always verify that architects' and general contractors' insurance policies had been renewed when insurance coverage expired before construction was completed.

MSHDA's standard agreements require architects to maintain insurance coverage for professional liability and general contractors to maintain insurance coverage for builders' risk, general liability, and workers' compensation claims. In all instances, the architects and general contractors are required to provide MSHDA with a copy of the certificate of insurance as proof of this coverage.

MSHDA's project files for 5 construction projects included documentation of the original insurance coverage from the architects and general contractors. However, we noted that this coverage had expired prior to the completion of the construction for the architects in 2 of the projects and for the general contractors in all 5 of the projects.

We also noted that the certificate of insurance provided by one general contractor did not specify the development that was being insured and did not include MSHDA as a certificate holder. Without receiving documentation that these insurance policies were properly renewed, MSHDA cannot be assured

that the development's architects and general contractors maintained the insurance necessary to protect MSHDA's interest in these developments. Without being listed as a certificate holder, MSHDA cannot be assured that the insurance was not canceled after the certificate was issued.

- b. MSHDA did not always verify that architects' and general contractors' licenses had been renewed when the licenses expired before construction was completed.

MSHDA's project files for 5 construction projects included documentation that the architects and general contractors were licensed. However, we noted that the licenses had expired prior to the completion of the construction for the architects in 4 of the projects and for the general contractors in all 5 of the projects.

Verification that the licenses are properly renewed would provide MSHDA some assurance that the architects and the general contractors continue to meet licensing requirements.

RECOMMENDATION

We recommend that MSHDA develop procedures to ensure that architects and general contractors maintain required insurance coverage and licensing until MSHDA-funded developments are completed.

AGENCY PRELIMINARY RESPONSE

MSHDA agreed with this finding and informed us that it has taken steps to implement the recommendation.

FINDING

7. Records of Proposed Developments

MSHDA had not developed effective internal control to ensure that records of proposed developments were properly maintained and safeguarded.

In our review of 10 proposed developments that were denied because of environmental reasons, MSHDA was unable to locate the environmental assessments for 4 (40%) proposed developments. Also, MSHDA was unable to

locate the memorandum indicating the environmental reason for denying 1 of the proposed developments.

MSHDA requires developers applying for MSHDA financing or LIHTCs to submit environmental site assessments with their applications. The assessments must be performed by environmental consultants in accordance with MSHDA's environmental review requirements. MSHDA staff review the assessments for compliance with MSHDA's requirements. Based on the information included in the environmental site assessments, MSHDA either approves the projects for further consideration or rejects the proposed developments. Sometimes, there are issues identified in the assessments that require additional investigation. Also, if the assessments were not performed according to MSHDA environmental review requirements, the proposed developments are rejected.

Unless accurate and complete records for all proposed developments are maintained and safeguarded, MSHDA cannot ensure and document that proposed developments received objective reviews. Frequently, projects are proposed a number of times before they are ultimately approved or the developer quits submitting LIHTC proposals for them. Being able to review the records from previous reviews may prevent duplication of efforts or alert MSHDA staff to potential problems.

RECOMMENDATION

We recommend that MSHDA develop effective internal control to ensure that records of proposed developments are properly maintained and safeguarded.

AGENCY PRELIMINARY RESPONSE

MSHDA agreed with this recommendation and informed us that it implemented the following procedure for the March 2000 and subsequent funding rounds. LIHTC staff maintain a log of all environmental studies that are submitted with LIHTC applications. The log identifies the name of the project, the date the environmental study was delivered to MSHDA's environmental specialist, the date it was returned to the LIHTC Program, and the date it was sent to the State records center. Policies of the records center require that each box sent for storage be given a unique identifier, and a corresponding list of the contents of each box is to be maintained by the LIHTC Program.

SAFEGUARDING FINANCIAL INTEREST

COMMENT

Background: MSHDA's Management and Reinvestment Unit monitors the finances and physical maintenance of developments that have MSHDA mortgages. The developments are required to provide MSHDA with monthly income and expense reports and annual audited financial statements.

MSHDA conducts on-site visits of each development on a regular basis to:

1. Evaluate the status of the development according to established criteria.
2. Ensure that MSHDA's investment in the development is secure.
3. Ensure that development programs are implemented according to MSHDA's governing principles.
4. Ensure that all federal, State, and local rules and regulations and laws are followed in the operation of the development.
5. Observe all aspects of development operations and discuss any problems or exceptions with the management agents as necessary.
6. Anticipate and identify problems or negative trends at the development before they occur.
7. Assist management agents in the identification and resolution of problems.

Audit Objective: To determine whether MSHDA safeguarded its financial interest in housing developments by monitoring the finances and physical maintenance of the developments.

Conclusion: We concluded that MSHDA effectively monitored the finances and physical maintenance of the developments.

TENANT ELIGIBILITY FOR RENT SUBSIDIES

COMMENT

Background: MSHDA's Management and Reinvestment Unit performs tenant eligibility audits at the various multifamily developments to ensure compliance with program requirements. The U.S. Department of Housing and Urban Development (HUD) established client eligibility requirements for rent subsidies.

Audit Objective: To assess the effectiveness of MSHDA's monitoring of tenant eligibility for rent subsidies at multifamily developments.

Conclusion: We concluded that MSHDA's monitoring of tenant eligibility for rent subsidies was effective.

TENANT REQUIREMENTS FOR FINANCING

COMMENT

Background: The multifamily developments operate under several HUD and MSHDA programs. The different programs have different eligibility requirements.

Audit Objective: To assess the effectiveness of MSHDA's monitoring of tenant income, age, and other requirements for the type of financing received to construct the multifamily developments.

Conclusion: We concluded that MSHDA's monitoring of tenant requirements for financing was generally effective. However, we noted reportable conditions related to comprehensive policies and procedures for tenant eligibility audits and selection of developments for tenant eligibility audits.

FINDING

8. Comprehensive Policies and Procedures for Tenant Eligibility Audits

MSHDA had not developed comprehensive policies and procedures for tenant eligibility audits of the various types of multifamily developments. Our review disclosed that these audits were not sufficiently documented and were not conducted using a consistent methodology.

Management agents at multifamily developments are required to verify and retain proof that tenants meet program eligibility requirements. Each program may have different eligibility requirements. A given multifamily development frequently operates under two or more programs.

After a development is constructed, MSHDA prepares a fact sheet that specifies the eligibility requirements for the development. The tenant eligibility audits determine whether the developments are obtaining and retaining the required proof of eligibility. At least 80% of the tenant files selected for review must have the required eligibility documentation for the development to be considered in compliance. If developments are not in compliance, their management agents are subject to financial penalties. After the initial review of tenant files, the management agents are required to obtain proof of eligibility for errors noted.

Without comprehensive policies and procedures for these audits, individual compliance monitoring staff that perform these audits have developed unique methods and documentation standards for the audits.

Our review of tenant eligibility audit files disclosed that compliance monitoring staff did not include the following items:

- a. The method used to select tenant files for review or how the number of files selected for review was determined.
- b. A listing of tenant files that were reviewed at other than Section 8* or Section 236* developments.
- c. The criteria for determining what was to be considered a compliance exception. We noted some audit files that included items that were categorized as "acceptable/other." This category was used for tenant files that did not contain all required information but were not considered exceptions for computing the development's compliance rate.

* See glossary at end of report for definition.

In addition, we noted the following inconsistencies. Some compliance monitoring staff:

- (a) Selected more tenant files for review than HUD regulations required without an explanation of why these extra files were selected.
- (b) Did not include a copy of the fact sheet or a summary of eligibility requirements in the audit files for developments operating under programs other than Section 8 or Section 236. This information is not required for developments operating under the Section 8 or Section 236 programs. MSHDA had copies of the fact sheet at other locations, but there was nothing in the audit files to document the requirements that the compliance monitoring staff used in auditing.
- (c) Included copies of eligibility documentation in the audit files that the developments were required to obtain for the exceptions noted during the initial review of files, while others did not.

The various developments operated under several programs with differing eligibility requirements. Comprehensive written tenant eligibility audit policies and procedures would help ensure that these audits were appropriately, efficiently, and consistently conducted and sufficiently documented. Reviewing more tenant files than federal regulations require can be an inefficient use of resources unless there is an appropriate reason to expand the audit testing. MSHDA should document in the audit files reasons for reviewing more than the required number of tenant files.

Many of the multifamily developments operate under HUD-funded programs. MSHDA performs the tenant eligibility audits to determine compliance with HUD and MSHDA requirements. While HUD regulations do not include documentation standards for the tenant eligibility audits, sufficient information to demonstrate that the audit was properly conducted should be included in the audit files. There is a possibility that MSHDA may use these audits as a basis for financial sanctions against development management agents.

RECOMMENDATION

We recommend that MSHDA develop comprehensive policies and procedures for tenant eligibility audits of the various types of multifamily developments.

AGENCY PRELIMINARY RESPONSE

MSHDA agreed with this recommendation and informed us that the compliance monitoring for Section 8 developments, Section 236 developments, and MSHDA-financed developments has recently been combined with the LIHTC compliance monitoring unit. MSHDA added that comprehensive policies and procedures are being developed and that the comments of the Auditor General will be considered as part of the transition.

FINDING

9. Selection of Developments for Tenant Eligibility Audits

MSHDA did not select developments for tenant eligibility audits in accordance with the HUD Handbook.

MSHDA conducts tenant eligibility audits of each multifamily development every 15 months. HUD Handbook Section 4381.5 requires audits to be performed on a risk basis. Most of the developments have very few eligibility exceptions, while others routinely had very high rates of exceptions. During each audit, an exception rate is computed for the development. These exception rates could be compiled and used as the basis for determining the frequency that individual developments would be audited for tenant eligibility.

At the time of our audit, MSHDA was considering increasing the standard audit cycle from 15 to 18 months. MSHDA could obtain sufficient coverage of these developments with available staff by using a risk-based selection basis. MSHDA could also perform audits more frequently at developments with high exception rates. Most of the eligibility documentation required to be obtained and retained from tenants is on an annual basis. Having a standard audit frequency significantly longer than 12 months provides the at-risk developments with a period in which their client eligibility actions are not subject to audit.

MSHDA stated that HUD had given it a verbal waiver from this Handbook requirement. However, MSHDA did not provide us with any evidence of this waiver. Also, there were no provisions in the HUD Handbook for issuing verbal waivers from any of HUD's requirements.

Another unit within the Management and Reinvestment Unit that conducts financial monitoring of the MSHDA-financed multifamily developments uses a risk-based system for determining monitoring frequency. Our review disclosed that, with a limited number of staff, the unit spent a significant amount of time on developments with problems and yet had sufficient coverage of the remaining developments.

RECOMMENDATION

We recommend that MSHDA select developments for tenant eligibility audits in accordance with the HUD Handbook.

AGENCY PRELIMINARY RESPONSE

MSHDA agreed with this recommendation and informed us that the compliance monitoring for Section 8 developments, Section 236 developments, and MSHDA-financed developments has recently been combined with the LIHTC compliance monitoring unit. MSHDA added that comprehensive policies and procedures are being developed and that the comments of the Auditor General regarding the use of a risk-based approach will be considered as part of the transition.

Glossary of Acronyms and Terms

effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes.
HOME Program	A federally funded program to finance rental units for low-income households and special needs populations.
HUD	U.S. Department of Housing and Urban Development.
LIHTC	Low Income Housing Tax Credit.
mission	The agency's main purpose or the reason that the agency was established.
MSHDA	Michigan State Housing Development Authority.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
QAP	qualified allocation plan.
reportable condition	A matter coming to the auditor's attention that, in the auditor's judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.

Section 8	A federal program that provides rent subsidies for very low-income people who find their own housing in private homes and apartment buildings.
Section 236 development	A type of housing development in which all residents must meet income limits set by MSHDA and tenant selection criteria. Rent at a 236 development tends to be lower than other rental housing units because the mortgage interest rate is subsidized by HUD. A small number of units at a 236 development may receive rent supplement or rental assistance payments.
TEAM Program	Tax-Exempt Apartments for Michigan Program.